Supreme Court of the United States

OCTOBER TERM, 1948

No. 628

COMMERCE COMPANY, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit, and

BRIEF IN SUPPORT THEREOF

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SUBJECT INDEX

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Supreme Court of the United States

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No.________

COMMERCE COMPANY, *Petitioner*,

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UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit

TO THE HONORABLE THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner respectfully shows:

Summary Statement of the Matter Involved

This is a civil action brought in the District Court of the United States for the Southern District of Texas by Commerce Company, Petitioner, against United States of America, Respondent, for the recovery of Federal Income Taxes paid for the taxable period January 1 through December 31, 1938, in the amount of $2,262.45 and for the taxable period July 1, 1938, through May 31, 1939, in the amount of $1,713.38, as shown by the allegations of Petitioner's Complaint (R. 3 to 12).

The facts were stipulated (R. 14 to 33).

The Findings of Fact and Conclusions of Law, as amended (R. 34 to 37), fairly sets forth the issues involved, and judgment was rendered in favor of Respondent denying any recovery of taxes by Petitioner.

An appeal from said judgment was taken by Petitioner to the United States Court of Appeals, Fifth Circuit, which affirmed the judgment of the Trial Court.

The question involved on said appeal was whether in determining the basis of two buildings as at January 1, 1938, for depreciation purposes, the smaller depreciation determined by conference agreement in 1936 to be the proper deductions beginning with the construction of the two buildings in the profit year 1929, and extending through the two following profit years 1930 and 1931, should be deducted from basis for each of the loss years following 1931 and for which returns were filed prior to the conference agreement in 1936, or whether the larger depreciation shown on returns for such intervening loss years and based on Petitioner's original estimate (subsequently retroactively revised by the 1936 conference agreement), should be deducted. The United States Court of Appeals, Fifth Circuit, decided that question adversely to Petitioner (R. 43 to 50).

Jurisdictional Statement

It is contended that the Supreme Court has jurisdiction to review the judgment here in question under the provisions of Title 28, U. S. C., Section 2101, on the grounds that the Circuit Court has rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same matter, and that the Circuit Court has decided an important question of federal law which has not been, but

should be settled by this Court. The judgment of the Circuit Court of Appeals was rendered December 7, 1948.

Question Presented

The question herein presented is whether under the Revenue Act of 1938 the Government of the United States of America is authorized to adjust depreciation rates for years in which a taxpayer has a net profit, without consistently adjusting depreciation rates for intervening (not prior) years in which a taxpayer has a net loss.

Reasons Relied on for the Allowance of the Writ

The United States Court of Appeals, Fifth Circuit, has decided an important question of federal law directly contrary to all other decisions on the identical point, and has rendered a decision in conflict with the decision of PITTSBURGH BREWING COMPANY V. COMMISSIONER OF INTERNAL REVENUE, 107 F. (2d) 155, decided by the Circuit Court of Appeals for the Third on the same matter, and that the Circuit Court has decided an important question of federal law which has not been, but should be, settled by this Court.

WHEREFORE, your Petitioner prays that a Writ of Certiorari issue under the seal of this Court directed to the United States Court of Appeals for the Fifth Circuit commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court had in the case numbered and entitled on its docket No. 12357, Commerce Company, Appellant, v. United States of America, Appellee, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States, and that

the judgment herein of said Circuit Court be reversed by the Court and for such further relief as to this Court may seem proper.

Dated March 1, 1949.

COMMERCE COMPANY,

By________________________
BEN CONNALLY,
Counsel for Petitioner

Supreme Court of the United States

OCTOBER TERM, 1948

No.________

COMMERCE COMPANY, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinion of the Court Below

The opinion of the Court below is shown on pages 43 to 50 of the Record.

Jurisdiction

The date of the judgment of the Circuit Court of Appeals is December 7, 1948. The jurisdictional grounds are stated in the Petition for Writ of Error, and are adopted and made a part of this brief.

Statement of the Case

The statement contained in the Petition for Writ of Certiorari is adopted and made a part of this brief.

Specification of Error

The Circuit Court of Appeals erroneously applied the case of VIRGINIAN HOTEL CORPORATION v. HELVERING, 319 U.S. 523, which concerned a prospective revision of depreciation rates, to deny recovery of Petitioner in the present case, which concerns a revision of estimated depreciable life applied retroactively by the Government to the very year of construction, and following profit years, without adjusting intervening loss years.

Argument

Point A

The Circuit Court of Appeals erroneously applied the case of *Virginian Hotel Corporation v. Helvering*, 319 U.S. 523, which concerned a prospective revision of depreciation rates to deny recovery of Petitioner in the present case, which concerns a revision of estimated depreciable life applied retroactively by the Government to the very year of construction, and following profit years, without adjusting intervening loss years.

In applying the case of VIRGINIAN HOTEL CORPORATION v. HELVERING, 319 U.S. 523, it must be remembered that the Court was making its decision on a state of facts that included only an original estimate of depreciable life that existed for several years, and then a revision of estimated depreciable life at the end of that time, in which situation it was customary for both Taxpayer and Government to

consider and give effect to the revised estimate only on a prospective basis and not on a retroactive basis.

That decision on those facts cannot in good conscience be applied as precedent in the instant situation where the revision of estimated depreciable life was actually applied retroactively by the Government to the very year of the construction of the building. These revised estimated depreciation rates should be effective from the year of the construction of the building on a prospective basis from that date forward in what is the only fair, just, equitable, consistent and customary manner.

The crux of the matter lies in the construction of the phrase "to the extent allowed (but not less than the amount allowable)" in Section 113(b)(1)(B) of the REVENUE ACT OF 1938, which was the same wording enacted in 1932.

Sometimes we become so enamoured of a definition of a word that we lose sight of the setting in which a statute was enacted, its purpose, the equities of the situation to which it is applied, and all sense of fairness, justice and consistency.

Taxation is a practical matter. The Court finds no difficulty, when the equities of the situation require, in reading into the otherwise plain words of a tax statute various equitable modifications, such as ignoring a transaction or series of transactions coming strictly within the terms of the statutes, if undertaken without business purpose, or with an end result not in accordance with the "spirit" of the law; or lifting a taxpayer out of a mire of statutory words with a "tax-benefit" theory; or allowing a "recoupment" where there is no estoppel, but where, as here, a taxpayer has voluntarily stepped into an unconscionable tax trap.

The word "Allowed" means granted. It is rather an ambiguous word, inasmuch as it may mean different things to different men. What was the intent of the Congressional framers of the statute? It is apparent that their only thought

was that "the government might be barred from collecting additional taxes which would have been payable had the lower rate been used originally", and was not intended to create a new trap for taxpayers.

The present situation has never come before this Court. In the VIRGINIAN HOTEL case the taxpayer had deducted a certain rate in the profit years 1927 to 1930 without adjustment by the Government, and the rate had not been changed until 1938, when the Government revised the rate. All this Court had to decide in that case was whether the revision should apply to years already past.

That is a far cry from the present case. Should a hard and fast definition be followed blindly in all cases? "What is reasonably clear in a particular application is not to be overborne by the simple and familiar dialetic of suggesting doubtful and extreme cases," SANTA CRUZ FRUIT PACKING Co. v. NLRB, 303 U.S. 453. But what about the doubtful and extreme cases, when they actually come before the Court? Of the present situation we may well say with MR. JUSTICE RUTLEDGE in NEW YORK v. U. S., 326 U.S. 572, "Marshall spoke at a time when social complexities did not so clearly reveal as now the practical limitations of a rhetorical absolute."

In addition the Court below refused to follow the case of PITTSBURGH BREWING CO. v. COMMISSIONER OF INTERNAL REVENUE, 107 F. (2d) 155, decided by the Circuit Court of Appeals for the Third Circuit, which case has never been overruled by this Court. Petitioner's facts are like the facts of PITTSBURGH BREWING case as set out in 37 BTA 439. In that case Pittsburgh and the Government agreed in 1932 to allow certain depreciation deductions for 1918 to 1920. In the meantime from 1921 to 1931 Pittsburgh in its loss year returns had taken excessive depreciation computed without taking into account the 1918 to 1920 adjustments. The Court in that case allowed Pittsburgh to adjust its basis

in 1932 by the correct depreciation for the loss years 1921 to 1931 instead of the erroneous figure taken on its returns.

To allow a strained construction of a statute to permit the Government to arbitrarily and capriciously juggle depreciation between profit years and loss years to its benefit and to the taxpayer's disadvantage, is to leave the taxpayer a right without a remedy, to misinterpret the plain intent of Congress, and to condone a miscarriage of justice beyond all equity, fairness and reason.

It is therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing the decision of the Circuit Court of Appeals.

BEN CONNALLY,
Attorney for Petitioner

CHARLES H. DRAPER,
Of Counsel

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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 628

COMMERCE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The District Court rendered no opinion but entered findings of fact and conclusions of law (R. 34-37) which are unreported. The opinion of the Court of Appeals (R. 42-47) is reported in 171 F. 2d 189.

JURISDICTION

The judgment of the Court of Appeals was entered on December 7, 1948 (R. 48). The petition for a writ of certiorari was filed on March 5, 1949.

The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254.

QUESTION PRESENTED

The Commissioner of Internal Revenue adjusted the depreciation rates claimed by the owners of the Texas State Hotel properties and the Krupp and Tuffly Building for 1929, 1930 and 1931, pursuant to revenue agent reports and conferences relating to such years. No corresponding adjustments were made in the depreciation claimed on the Texas State Hotel properties for the years 1932, 1933 and 1935, and the Krupp and Tuffly Building for the years 1932, 1933, 1934 and 1935. The tax returns of the owners for these latter years were accepted by the Commissioner as filed.

The question here presented is whether, in determining the "adjusted basis" of the properties for the purpose of computing depreciation on the Texas State Hotel properties for the taxable periods in suit and for the purpose of computing the deductible loss from the sale of the Krupp and Tuffly Building on May 31, 1938, the full amount of the deductions taken as depreciation in the years in which the returns were accepted as filed should be subtracted from the cost, or only an amount equal to the depreciation for such years computed at the rates used by the Commissioner for 1929, 1930 and 1931. The answer depends upon whether the deductions for depreciation claimed in the owners' tax returns which were accepted as filed were

"allowed" within the meaning of Section 113 (b)(1)(B) of the Revenue Act of 1938.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix, *infra*, pp. 15-18.

STATEMENT

This is an action brought against the United States by the Commerce Company (herein sometimes referred to as the taxpayer) for the recovery of income tax paid. For the period January 1, 1938, to September 23, 1938, the taxes were assessed to and collected from the taxpayer as transferee of State Properties Corporation. The taxes were paid by the taxpayer on its own account for the fiscal year June 1, 1938 to May 31, 1939. (R. 14.) All facts were stipulated and the only question involved is with the respect to the computation of the adjusted basis on the Texas State Hotel properties and the Krupp and Tuffly Building for the periods in suit. The Texas State Hotel properties include ten individual items (R. 29, 30, 31) on each of which depreciation was allowed in the years 1929 through 1937, at rates peculiarly applicable to each item. Four separate items were similarly treated in connection with the Krupp and Tuffly Building. (R. 32.)

In the following statement, for the sake of clarity, reference to precise figures with respect to cost and depreciation has been omitted. The

figures are set forth in the stipulation of facts (R. 29-33).

Texas State Hotel Properties.—The Texas State Hotel properties were first placed in use in 1929. They were owned and operated by the Theo Development Company from 1929, to December 31, 1931, when the name of the company was changed by charter amendment to Texas State Company. The Texas State Company owned and operated the Texas State Hotel properties from December 31, 1931, to September 30, 1936, when they were transferred to State Properties Corporation. The transfer to State Properties Corporation was a tax-free transaction. On July 1, 1938, the State Properties Corporation transferred all of its assets and liabilities to the taxpayer through a tax-free reorganization. (R. 15, 19.) Inasmuch as the transfer to State Properties Corporation and the reorganization whereby the taxpayer acquired the assets of State Properties Corporation were tax-free transactions, the taxpayer acquired the depreciation basis of the prior owners.

The owners of the Texas State Hotel properties filed income tax returns for each year from 1929, through 1937, and claimed deductions for depreciation on such properties each year (R. 19-22). The depreciation claimed for the years 1929, 1930 and 1931, was partially disallowed by the Commissioner of Internal Revenue. This action was taken pursuant to a conference report dated August 29, 1936, it having been agreed that the useful life of

the properties had been underestimated in the returns for these years and that the depreciation rates used in computing the deductions claimed in the returns should be adjusted accordingly. (R. 19-20.)

Pursuant to subsequent revenue agent reports, a part of the deductions for depreciation claimed for the year 1934, the taxable periods in 1936 and the year 1937, was also disallowed. The depreciation allowed for 1934, and the taxable periods in 1936, was recomputed by employing the rates finally used by the Commissioner for 1929, 1930 and 1931. For the year 1937, the same rates were used on all items except the building and the elevators. It was decided that the building and elevators had a longer useful life than previously estimated and an appropriate change was made with respect to their depreciation rates. (R. 21-23.)

The Commissioner of Internal Revenue accepted the income tax returns of the owners of the properties for 1932, 1933 and 1935, as filed, and made no challenge to the deductions for depreciation taken in them. The depreciation allowed in these returns was at a higher rate than was finally allowed for 1929, 1930 and 1931. During the years 1932, 1933 and 1935, the returns disclosed a net loss in excess of the difference between the amount of depreciation claimed and the amount allowable for those years at the rates finally used by the

Commissioner for the years 1929, 1930 and 1931. (R. 20-22.)

In determining the adjusted basis for computing depreciation on the Texas State Hotel properties for the period involved in this suit, beginning January 1, 1938, the Commissioner of Internal Revenue subtracted from the cost of the properties the full amount of the depreciation claimed in the returns accepted as filed for the years 1932, 1933 and 1935, as well as the amount allowed pursuant to the various revenue agent and conference reports for the other years in which the building had been in use. The adjusted basis of each property item thus determined was then divided by the estimated number of years of remaining useful life of the item to determine the depreciation deduction for the taxable periods here involved. (R. 30.)

The taxpayer contends that the Commissioner of Internal Revenue erred with respect to the years in suit in subtracting from the cost of the Texas State Hotel properties the full amount of depreciation claimed in the tax returns of the owners for the years 1932, 1933 and 1935. It contends that only a sum equal to the depreciation allowable for those years at the rates finally used for 1929, 1930 and 1931, should have been subtracted. The District Court and the Court of Appeals sustained the Commissioner's action. (R. 35, 47.)

Krupp and Tuffly Building.—Substantially the same problem arises with respect to the Krupp and Tuffly Building. This building was erected

by the Hewitt Construction Company in 1929, a subsidiary of Jesse H. Jones & Company, and was transferred upon completion to the Southern Loan and Investment Company, then also a subsidiary of Jesse H. Jones & Company. This transfer was a tax-free transaction. On December 31, 1932, the building was transferred to Hippodrome Building and Amusement Company and this was a tax-free transaction. On September 30, 1936, the name of the Hippodrome Building and Amusement Company was changed to State Properties Corporation. (R. 24.) As pointed out above, the taxpayer is a successor through a tax-free reorganization of the assets and liabilities of the State Properties Corporation. Inasmuch as the transfers of the building were tax-free transactions, the State Properties Corporation, of which the taxpayer is transferee, acquired the depreciation basis of the former owners.

The total cost of the Krupp and Tuffly Building, including additions, was $211,799.50 (R. 32). It was sold on May 31, 1938, by State Properties Corporation to the Southern Loan and Investment Company for the sum of $152,348.93. This was a taxable transaction. (R. 27-28.)

From 1929 through 1937, the owners of the building filed income tax returns and therein claimed deductions for depreciation on the building. The rates used in the returns were the same for each year. The Commissioner of Internal Revenue

adjusted the amounts of depreciation claimed in the returns for the years 1929, 1930 and 1931, pursuant to a conference report dated July 13, 1936, and allowed only a part of the depreciation claimed. The returns for all other years were accepted by the Commissioner as filed. (R. 24-26.)

In computing the loss from the sale of the Krupp and Tuffly Building, the Commissioner deducted from the cost of $211,799.50 the amount of the depreciation allowed for the years 1929, 1930 and 1931, the full amount claimed in the income tax returns filed for the years 1932 through 1937, and the amount claimed for the period January 1, 1938, to the date of the sale, May 31, 1938. The total amount of such depreciation was $55,488.02. (R. 32.) The difference between this amount and the cost of the building is $156,311.48, and this figure was taken as the adjusted basis. The difference between this figure of $156,311.48 and the sales price of $152,348.93 is $3,962.55, and this was the amount allowed by the Commissioner as a deductible loss. (R. 33.)

The taxpayer contends that the Commissioner erred in deducting from the cost the full amount of the depreciation claimed in the tax returns of the owners for the years 1932, 1933, 1934 and 1935, years in which the owners' income tax returns disclosed net losses (R. 20, 25-26). It is of the view that the Commissioner should have subtracted in respect of these years only a sum equal to the depreciation allowable at the rates finally used by

the Commissioner for the years 1929, 1930 and 1931. Both the District Court and the Court of Appeals sustained the action of the Commissioner. (R. 36, 47.)

ARGUMENT

1. The controlling statute is Section 113 (b)(1)-(B) of the Revenue Act of 1938, Appendix, *infra*, p. 16, which provides that the "adjusted basis" for computing gain or loss (and depreciation under other statutory provisions) shall be determined by making proper adjustments for exhaustion, wear and tear, and obsolescence in prior years "to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws." In *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, rehearing denied, 320 U. S. 810, the petitioner claimed deductions for depreciation in its returns for 1927 through 1937 at rates in excess of those determined for 1938. For the years 1931 through 1936, the petitioner had net losses in excess of the amounts of depreciation claimed as deductions. The petitioner contended that its adjusted basis for 1938 should be computed by subtracting from the cost, in respect of the years 1931 through 1936, only an amount equal to the deduction allowable for those years at the rates used for 1938, because it had received no tax benefit from the excessive deductions. This Court held that under Section 113 (b)-(1)(B), excessive amounts deducted from gross income in prior years as depreciation should be deducted from the cost of the property in question in

determining the adjusted basis of the property for the current taxable year even though, in the earlier years, no tax benefit was realized by the taxpayer from such excessive deductions.[1]

The *Virginian Hotel* case was in no material respect different from the one here presented. In both cases, the Revenue Act of 1938 was the controlling statute. The taxpayer in each case filed, for years in which no net income was realized, tax returns in which amounts were deducted as depreciation on the properties involved in excess of the rates finally determined and agreed upon with the Commissioner of Internal Revenue in respect of other years. These returns were accepted as filed and no challenge was made of the deductions for depreciation therein made. In each case, in computing the adjusted basis for the tax periods in 1938, the Commissioner subtracted from the cost of the properties the full amount of the depreciation claimed in the accepted returns and allowed depreciation (and here the loss on the sale of the Krupp and Tuffly Building) in accordance with the adjusted basis so computed. In each case, the taxpayer contended that the cost basis should be reduced with respect to the loss years only by an amount equal to a deduction allowable at rates agreed upon by the taxpayer

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[1] Certiorari has since been denied in the following cases presenting this issue: *Commissioner* v. *Kennedy Laund. Co.*, 133 F. 2d 660 (C.A. 7th), certiorari denied, 319 U.S. 770; *Repplier Coal Co.* v. *Commissioner*, 140 F. 2d 554 (C.A. 3d), certiorari denied, 323 U.S. 736; *Bank of America Nat. Trust & Sav. Ass'n* v. *United States*, 168 F. 2d 399 (C.A. 9th), certiorari denied, 335 U.S. 827.

and the Commissioner in connection with other years and that the difference between such amounts and the amounts claimed in the returns should be restored to the adjusted basis for 1938. The action taken by the Commissioner on the tax returns for the loss years and the contentions of the taxpayers with respect to them are, therefore, the same in both cases.

The only difference between the underlying facts in the two cases is with respect to the action taken by the Commissioner on the returns for prior years in which net income was reported. In *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, rehearing denied, 320 U. S. 810, the Commissioner accepted as filed the returns for prior years in which net income was reported and did not challenge the deductions for depreciation taken in them. The adjusted basis for 1938 was computed by subtracting from the cost the full amount claimed in the returns for such years. In the instant case, the Commissioner made adjustments of the depreciation claimed on the Texas State Hotel properties for 1929, 1930, 1931, 1934, 1936 and 1937, and on the Krupp and Tuffly Building for 1929, 1930 and 1931. In computing the adjusted basis for 1938, the amounts allowed as depreciation for these years in accordance with the adjustments so made were subtracted from the cost.

The taxpayer does not here challenge the correctness of the adjustments made by the Commissioner in respect of the depreciation rates for prior years

in which net income was received or the correctness of the Commissioner's action in subtracting from the cost the revised amounts for those years for the purpose of computing the adjusted basis. However, the taxpayer argues that the rule of the *Virginian Hotel* case is inapplicable because the depreciation rates were here adjusted for 1929, 1930 and 1931, years prior to the loss years, whereas in the *Virginian Hotel* case the rate adjustments were made for 1938, a year subsequent to the loss years.

This factual difference obviously does not affect the question whether the depreciation claimed in the returns accepted by the Commissioner as filed for the loss years was "allowed" within the meaning of Section 113 (b) (1) (B). There is nothing in the statute to suggest that this difference between the two cases dictates or even permits a different result. The revenue laws impose no more obligation upon the Commissioner to make audits and corresponding corrections in returns for net loss years subsequent to the years for which audits are made than it does in respect of returns for prior years. The taxpayer suggests no concrete reason stated in the statute, its language or its legislative history, which would cause the result in this case to be different from that in the *Virginian Hotel* case. The taxpayer's general plea that this Court develop some theory or another to lift it "out of a mire of statutory words" (Pet. 7) indicates that it recognizes that no such reason exists.

That the Commissioner's action with respect to the return for one taxable year is not determinative of whether a deduction for depreciation has been allowed in another is shown by the language of this Court in *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, rehearing denied, 320 U. S. 810. After explaining the purpose of Section 113 (b)-(1)(B), this Court said (p. 527):

> Under our federal tax system there is no machinery for formal allowances of deductions from gross income. Deductions stand if the Commissioner takes no steps to challenge them. Income tax returns entail numerous deductions. If the deductions are not challenged, they certainly are "allowed," since tax liability is then determined on the basis of the returns. * * *

From the foregoing, it seems apparent that the court below was correct in its conclusion that the instant case is controlled by the decision of this Court in the *Virginian Hotel* case and that the case was correctly decided.

2. There is no merit in the taxpayer's contention (Pet. 8) that a writ of certiorari should be granted in the instant case because of a conflict with *Pittsburgh Brewing Co.* v. *Commissioner,* 107 F. 2d 155 (C.A. 3d). If, as the taxpayer states (Pet. 8), its "facts are like the facts of the *Pittsburgh Brewing* case," this Court has, in effect, already upheld the correctness of the decision below. For, in its opinion in the *Virginian Hotel* case (319 U. S. at 525),

this Court stated that it had granted certiorari "because of a conflict between the decision below and *Pittsburgh Brewing Co.* v. *Commissioner,* 107 F. 2d 155, decided by the Circuit Court of Appeals for the Third Circuit." The conflict was resolved by rejecting the rule announced in the *Pittsburgh Brewing* case. As pointed out in the quotation from *Repplier Coal Co.* v. *Commissioner,* 140 F. 2d 554, 558 (C.A. 3d), in the opinion below in the instant case (R. 46), the decision in the *Pittsburgh Brewing Co.* case "was in effect overruled" by this Court in the *Virginian Hotel* case. And if the facts in this case differ materially from those involved in the *Pittsburgh Brewing* case, there is no conflict.

CONCLUSION

The decision below is correct. It is in accord with the decision of this Court in *Virginian Hotel Co.* v. *Helvering, supra.* It involves no conflict which has not previously been resolved. The petition for a writ of certiorari should, therefore, be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General;
THERON LAMAR CAUDLE,
Assistant Attorney General;
ELLIS N. SLACK,
LEE A. JACKSON,
C. MOXLEY FEATHERSTON,
Special Assistants to the Attorney General.

APRIL, 1949.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(i) *Basis for Determining Loss.*—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), and for bad debts, to be allowed under subsection (k), shall be the adjusted basis provided in section 113 (b) for determining the loss from the sale or other disposition of property.

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

* * * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) * * * The basis of property shall be the cost of such property; * * *

*　*　*　*　*

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

*　*　*　*　*

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

*　*　*　*　*

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

*　*　*　*　*

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 113(b)-1. *Adjusted basis: General rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, is the cost of such property or, in the case of such property as is described in paragraphs (1) to (18), inclusive, of section 113(a), the basis therein provided, adjusted to the extent provided in section 113 (b).

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. * * *

* * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect of any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under the Revenue Act of 1938 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determina-

tion of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted. * * *

* * * * *

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Supreme Court of the United States

October Term, 1948

No. 628

Commerce Company, *Petitioner*,

v.

United States of America, *Respondent*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF AMICUS CURIAE

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Washington, D. C.

Wilson - Epes Printing Co. - RE 6003 - Washington 1, D. C.

Supreme Court of the United States

October Term, 1948

No. 628

COMMERCE COMPANY, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

The Undersigned Respectfully Moves This Honorable Court for Leave to File the Annexed Brief as *Amicus Curiae.*

WILLIAM A. SUTHERLAND,
Ring Building
Washington, D. C.

Supreme Court of the United States

October Term, 1948

No. 628

Commerce Company, *Petitioner*,

v.

United States of America, *Respondent*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF AMICUS CURIAE

The case of *Virginian Hotel Corporation v. Helvering*, 319 U. S. 523, No. 766, October Term 1942, decided by a vote of five to four, appears to me to govern this case. But the clear absurdity of the *Virginian Hotel* decision, as demonstrated by the result of applying it to the present case, strongly demands that certiorari be granted in this case so that the applicable rules of law may be re-examined.

It is safe to say that there is no reasonable likelihood that this Court would have decided as it did in the *Virginian Hotel* case had the facts of the present case been before it.

The *Virginian Hotel* case involved a situation where depreciation on property at certain rates had been shown on tax returns in a series of profit years, and then throughout in a series of subsequent loss years, and then in a series of later profit years. The Commissioner corrected the rate of depreciation in the second series of profit years on the ground that the correct depreciation rate was less than that claimed. The property had a longer life than had been claimed. When the rate was corrected in the later profit years, the taxpayer urged that it should be permitted to correct the excess depreciation in the loss years, for purposes of determining the correct basis of the property at the beginning of the second series of profit years. The Court held that the taxpayer was not entitled to correct the rate in the *preceding* loss years, although no tax loss resulted to the government from the excess depreciation claimed in those years. There was confusion in the argument and brief for the Commissioner as to whether there was a real error in the earlier years or whether the estimate of useful life was reasonable when made and simply turned out in later years to have been a mistake in judgment.[1] And that confusion colored the whole case.

[1] This confusion is apparent from a reading of the Government's brief on the merits in the *Virginian Hotel* case, which reveal clearly that the Government was objecting to a taxpayer being able retroactively to change depreciation allowances claimed when, *because of future events*, the original estimate turned out to be wrong. The Solicitor General's argument in that case was not directed squarely to a situation where a clear error was made at the time of filing of the return and where the Commissioner would have disallowed part of the amount claimed if he had investigated the return the day it was filed. Extracts from the Government's brief on the merits in the *Virginian Hotel* case which illustrate the

The present case presents the issue involved in the *Virginian Hotel* case in such a way as to leave no trace of doubt that what is involved is a true error on the part of the taxpayer, not just a bad choice by the taxpayer between two permissible claims. In fact, the government's treatment of the taxpayer in the present case shows conclusively that the government recognizes the error in the depreciation claimed to have been a genuine error. *And the error was determinable, and has actually been determined, even for years prior to the loss years for which correction has been refused.*

In the present case the buildings involved were constructed in 1929. Profits were made in 1929, 1930 and 1931. There were losses in 1932, 1933, 1934 and 1935. The same depreciation was shown in the returns for all years. In a conference in 1936 covering the years 1929 to 1931, it was agreed between the taxpayer and the Commissioner that the rate was excessive, and the taxes due by the taxpayer for 1929, 1930 and 1931 were increased because of the correction of the error in the depreciation claimed. Nevertheless the Commissioner has refused to correct the error in the loss years, 1932 to 1935.

In other words, the Commissioner has insisted that the basis of the property reflect the erroneous depreciation shown on the returns during those loss years, even though the Commissioner has already collected additional taxes by correcting the error in the *preceding* profit years. It is clear that at the time the tax returns showing the excessive depreciation were filed, the depreciation was erroneous to the extent of the excess. The result is so obviously absurd

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confusion in the Government's presentation of the case to this Court are printed as an appendix to this brief.

If any examination is made of the briefs in the *Virginian Hotel* case, it is suggested that the briefs on rehearing bound with the briefs and records of the October Term 1943 be examined.

as to refute any construction of an ambiguous statute which requires such result.

If this Court had had such facts before it in the *Virginian Hotel* case, it seems hardly conceivable that any member of this Court would have concluded that, in computing the basis of its property at January, 1938, the taxpayer had to deduct the erroneous amounts shown on the returns for 1932 to 1935, even though the Government had suffered no harm from the showing of these erroneous amounts on the return, and even though the Commissioner had already admitted the error by correcting the deduction for 1929 to 1931 and for the years following 1935. No reason can be suggested why Congress would even consider passing a law which would require such a result. If the *Virginian Hotel* decision requires such a result — and its language does seem to require it — the decision should be reexamined without delay.

If the *Virginian Hotel* decision does apply to the present case it is obvious that the effect of the decision is to bind a taxpayer in computing his taxes in subsequent years by an error made in preceding years, where the government has not suffered and the taxpayer has not benefited in any way by the error. Never in the whole history of income taxes has Congress or have the Courts evidenced the slightest inclination to bind a taxpayer by errors made in preceding years, except where some injury has resulted to the Government upon which estoppel might be based. It is a fundamental principle of our income tax system that each year stands on its own basis and that the tax for each year is to be *correctly determined*. If there is to be a departure from this universal principle in some particular case, based on errors in returns for other years, this Court should demand the clearest showing that Congress has required it.

The legislative history of Section 113(b)(1)(B) makes it clear that Congress never even considered the possibility

of such a result, but rather was merely seeking, in enacting Section 113(b)(1)(B), to make it clear that where a taxpayer had reduced his taxable income by excessive depreciation—depreciation in excess of "allowable" depreciation—he could not restore that amount to his basis and in effect get to deduct it again. The statute was not aimed at penalizing errors shown on returns. It was aimed at preventing the double *use* of deductions in computing taxes—not at the meaningless writing of figures on returns where no taxes were due even in the absence of those figures. Congress was clearly enacting a statutory estoppel and nothing more. And there is nothing in the statute or in its legislative history to suggest that the estoppel should apply where injury, a necessary element of all estoppel, was absent.

It is impossible in the short space of an amicus brief on petition for certiorari to argue the matters which should be argued in the presentation of this case to the Court. But it is respectfully requested that at a time when unanimous decisions of the Supreme Court of many years standing are being reexamined and reversed, the decision in the *Virginian Hotel Corporation* case should not be permitted to stand in the light of the obviously absurd results which it requires.

Respectfully submitted,

W. A. SUTHERLAND,
Amicus Curiae

APPENDIX

Extracts from Brief for the Commissioner in the Virginian Hotel Case

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The taxpayer, however, would turn the rate reduction to its definite advantage. Except insofar as the statutes have specifically provided for loss carry-overs, the revenue laws do not contemplate that a taxpayer shall be allowed to take advantage in a later year of deductions available in earlier years which gave it no tax benefit because of insufficiency of income. Each tax year stands on its own footing. Burnet v. Sanford & Brooks Co., 282 U. S. 359. Consistently with the depreciation schedule which had been employed since 1927, with the approval of the Commissioner, the taxpayer continued to take these deductions through its loss years 1931-1936. *The deductions were actually available to it, just like any other deduction to which it was then entitled, although it was subsequently found that the amount had been excessive.* Indeed, the taxpayer continued to use the same rate in the year 1937 when it had net income and admittedly derived a tax benefit from the excessive claim, which it could not have done if it had undertaken to reduce the rate. Ordinarily the taxpayer could not expect to recoup the deductions wasted in its bad years. What its position here means is that the necessity of having to reduce the rate in 1938 should serve as an occasion to permit it to recoup its wasted deductions. This would not have been permitted if the rates had not been changed; there is no reason why this circumstance should serve as an excuse. (p. 13)

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The statutory allowances for depreciation provide a taxpayer an opportunity to recover tax-free his investment in property which is used in producing income and is being consumed or is deteriorating in the process. In taking the deductions, he is required to estimate in advance the anticipated life of the property and is required to spread the deductions over that estimated life. Thus, if he estimates that the property will have a useful life of 20 years, he will each year

deduct from income 1/20 of the cost or other basis of the property; accordingly, over the 20 years he is deriving income from the property he will be permitted to take deductions equal to his investment in the property.

Based as it is on beforehand estimates of useful life, the method, of course, cannot be precise and adjustments will sometimes be necessary. *Experience with the property will often show that the useful life of the property has been overestimated or underestimated. When this occurs, a new estimate is made, and the basis of the property, to the extent that it has not been recovered by prior deductions, is spread over the remaining life as thus reappraised.*[2] This is accomplished under the statute involved here, by reducing the original basis by depreciation previously "allowed," or that "allowable," whichever amount is greater, and by applying to this adjusted basis the new rate calculated upon the new estimate of useful life. For example, if after 15 years it were determined that property, instead of having a 20-year life (with 5 years remaining), had a 25-year life (with 10 years remaining), the remaining unrecovered basis would be spread over 10 years instead of 5. As a consequence, the deduction for each year would be half as large as under the original computation, but the privilege of taking depreciation deductions would last twice as long. (pp. 9-11)

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[all italics added]

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[2] No adjustment is made for the depreciation deductions *for the years preceding the reappraisal* which are still open under the statute of limitations. Sample-Durick Co. v. Commissioner, 35 B. T. A. 1186.